Rohauer v. Commissioner, 16 T.C. 1317 (1951)

Payments received for relinquishing rights under a personal services contract, where the contract is immediately canceled and replaced with a new agreement involving a different party, are considered ordinary income, not capital gains, especially when the payments represent commissions earned on contracts the taxpayer originally procured.

Summary

The petitioner, an agent for Frank Sinatra, sought to treat a portion of payments received from MCA (a talent agency) as a long-term capital gain, arguing it represented the sale of agency contracts. The Tax Court upheld the Commissioner's determination that the entire amount was ordinary income. The court reasoned that the contracts were for personal services, not readily salable, and that the arrangement with MCA involved the cancellation of the petitioner's contracts and the creation of new ones. Further, the payments received by the petitioner were largely attributable to commissions earned on existing contracts, taxable as ordinary income.

Facts

The petitioner was Frank Sinatra's agent and had contracts entitling him to 10% of Sinatra's earnings. The petitioner entered into an agreement with MCA, another talent agency, whereby MCA would become Sinatra's exclusive agent. As part of this agreement, the petitioner's existing contracts with Sinatra were canceled. MCA would then enter into new contracts with Sinatra. The petitioner received payments from MCA and sought to treat a portion of these as a long-term capital gain.

Procedural History

The Commissioner of Internal Revenue determined that the payments received by the petitioner from MCA were ordinary income. The petitioner challenged this determination in the Tax Court. The Tax Court upheld the Commissioner's determination.

Issue(s)

Whether payments received by the petitioner from MCA, stemming from the termination of personal services contracts and the commencement of new contracts between MCA and Frank Sinatra, constitute a long-term capital gain or ordinary income.

Holding

No, because the contracts were for personal services, not readily salable; the agreement involved the cancellation of the petitioner's contracts and the creation of new ones with MCA; and the payments largely represented commissions earned on contracts originally obtained by the petitioner for Sinatra. These commissions remained taxable to the petitioner as ordinary income.

Court's Reasoning

The court reasoned that the contracts were for personal services and not the type of property susceptible to ownership for a length of time like a share of stock or a bond. It cited *Thurlow E. McFall, 34 B. T. A. 108* stating "Petitioners did not sell their contracts, for inherently this they could not do. The contracts bound them to perform services of skill." The court emphasized that the petitioner's contracts were canceled, and MCA entered into new contracts with Sinatra, meaning nothing was actually *sold* to MCA in the traditional sense. The court also found that the payments received by the petitioner were largely commissions earned on contracts the petitioner had originally procured for Sinatra. The court noted, "The petitioner was entitled to that income as soon as Sinatra performed the services and could not, by assigning the income, relieve itself of tax on that income which, so far as the petitioner was concerned, was earned when the petitioner obtained the contract of employment for Sinatra." Citing the anticipatory assignment of income doctrine as articulated in *Lucas v. Earl, 281 U. S. 111*.

Practical Implications

This case clarifies the distinction between capital gains and ordinary income in the context of personal services contracts. It highlights that payments received for relinquishing rights under a service contract, especially when coupled with the creation of new contractual relationships, are likely to be treated as ordinary income. The case underscores that simply labeling a transaction as a

